

General Information Letter: Employer maintaining an office or transacting business in Illinois is required to withhold Illinois income tax from compensation paid in Illinois to its employees.

November 12, 1999

Dear:

This is in response to your letter dated October 12, 1999, in which you inquire about the withholding requirements of employers in Illinois. The nature of your letter and the information you provided require that we respond with a General Information Letter, which is designed to provide general information, but which is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter you stated the following:

xxxxxxxxxxxxx is one of the leading providers of tax compliance software. Our various products include payroll tax calculation applications used by large corporations throughout the U.S. and Canada.

Our clients rely on us to accurately calculate the withholding tax required by each state jurisdiction. We ask that you review the following question so that we can be assured we are in compliance with your state tax guidelines.

If an employer is **a resident** of your state and wages are earned outside the state, what would their tax obligation be:

1. Does resident tax apply if the work state does not have withholding?
2. Do you allow work tax as a credit towards resident tax?
3. If you allow a credit and the work tax is lower than the resident tax can the difference be remitted per pay period instead of at the end of the year, and is this optional or mandatory?
 - A. If yes; do we show tax withheld and total wages when remitting and filing tax returns.

Response

The general test for determining whether compensation is subject to Illinois income tax withholding is whether the compensation is paid in Illinois. Section 701(a)(1) of the Illinois Income Tax Act (35 ILCS 5/101 et seq.; the "IITA") provides that every employer maintaining an office or transacting business within Illinois, and required to withhold federal income tax, must withhold Illinois income tax on compensation paid in this State. (See IITA Section 701(a)(1), a copy of which is enclosed.) The Revenue regulations provide that compensation is paid in this State if:

- A) The individual's service is localized in this State because it is performed entirely within this State;
- B) The individual's service is localized in this State although it is performed both within and without this State, because the service performed without this State is incidental to the individual's service performed within this State; or

- C) The individual's service is not localized in any state but some of the service is performed within this State and either; the base of operations, or if there is not a base of operations, the place from which the service is directed or controlled is within this State, or the base of operations of the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

(See 86 Ill. Adm. Code Section 100.7010, a copy of which is enclosed).

If under Section 100.7010 compensation is considered paid in this State, then the entire amount of such compensation is subject to Illinois withholding, and the employer is responsible for fully withholding Illinois income tax from wages. However, where the Director of Revenue has entered into a reciprocal withholding exemption agreement with the taxing authorities of a state which imposes an income tax on compensation, each state's respective residents will be exempt from withholding in the nonresident state on their compensation paid in the nonresident state. (See IITA Section 701(d); 86 Ill. Adm. Code Section 100.7090). Currently, the Illinois Department of Revenue maintains reciprocal agreements with Iowa, Kentucky, Michigan and Wisconsin.

Compensation will not be subject to withholding, and an employer will not be required to withhold, under IITA Section 701(a)(1) if after application of Section 100.7010 the compensation is not considered paid in this State. However, under Section 701(a)(2) and (b) any payment, including compensation, by a payor maintaining an office or transacting business in Illinois but which does not meet the tests in Section 100.7010, will still be subject to Illinois withholding where certain conditions are present. If the recipient of such payment is a resident of Illinois, the payment is included in the recipient's base income, the payment is subject to federal withholding and the payment is not subject to withholding by another state, then the payment will be deemed compensation paid in this State by an employer and subject to Illinois withholding by the employer. (See IITA Section 701(a)(2) and (b)). If, however, such payment is subject to withholding by another state, a signed declaration by the payee to that effect will relieve the payor of the requirement to withhold Illinois income tax on the payment. (See 86 Ill. Adm. Code Section 100.7030(c)(2), a copy of which is enclosed).

In regards to a credit towards income tax withheld in another state, such credit shall be taken, when allowable, on the employee's tax return, rather than taken into account on the employer's withholding returns. An Illinois resident employee, in filing his or her Illinois income tax return, is required to report compensation paid in another state. IITA Section 301(a) provides that "all items of income or deduction taken into account in computing base income for the taxable year shall be allocated to this State". (See IITA Section 301). Base income is the individual's federal adjusted gross income subject to certain statutory addition and subtraction modifications. (See IITA Section 203(a)). A credit is allowable against a resident employee's Illinois income tax liability for the aggregate amount of income tax paid in a taxable year to another state on income which is also subject to Illinois income tax but which is not considered compensation paid in this State. (See IITA Section 601(b)(3), a copy of which is enclosed).

Enclosed for your review and use is a copy of the Department's Booklet IL-700

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"Illinois Withholding Tax Guide" and which may be useful in assisting your clients in meeting their withholding requirements in Illinois.

As stated above, this is a General Information Letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Sincerely,

Dana Deen Kinion
Associate Counsel-- Income Tax